IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 124 of 1984

For Approval and Signature:

Hon'ble MR.JUSTICE R.BALIA. and
MR.JUSTICE A.R.DAVE

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1. Whether Reporters of Local Papers may be allowed to see the judgements?

2. To be referred to the Reporter or not?

3. Whether Their Lordships wish to see the fair copy of the judgement?

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder?

5. Whether it is to be circulated to the Civil Judge?

COMMISSIONER OF INCOME-TAX

Versus

SUPER SCIENTIFIC CLOCK CO.

Appearance:

MR MANISH R BHATT for Petitioner

SERVED BY RPAD - (N) for Respondent No. 1

CORAM : MR.JUSTICE R.BALIA. and
MR.JUSTICE A.R.DAVE

Date of decision: 22/12/98

ORAL JUDGEMENT

1. The following question has been referred at the instance of revenue and statement of case has been submitted by the Tribunal to this Court on an application made under Section 256(1) of the Income Tax Act by the Commissioner of Income Tax in respect of assessment for

the assessment year 1977-78 in the case of respondent assessee:

"Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in coming to the conclusion that the sum of Rs.89,722/- paid as know-how fees to the foreign collaborator by the assessee was an allowable expenditure for the assessment year in question?"

2. The facts and circumstances in which the aforesaid question has been referred to this court are that a sum of Rs.89,722/- paid by the assessee to its foreign collaborator as technical-knowhow fees during the previous year relevant to assessment year 1976-77 was not allowed as deduction by the assessing officer on the ground that the liability to pay had arisen during the previous year relevant to assessment year 1975-76 and assessee is not entitled to claim the same on the payment basis for the assessment year 1976-77 as he is maintaining his accounts on mercantile basis. The assessee's plea that in respect of this payment, he has followed cash system of accounting though otherwise he has followed the mercantile system of account has not been accepted by the assessing officer. The plea did not find favour with the CIT (Appeals) either, and he observed that as the assessee has not provided for tax liability in the year in which it has accrued and claimed deduction thereon, it cannot claim deduction for the subsequent year of actual payment. The Tribunal on further appeal held, the liability did not accrue, because of the provisions of Section 9 of the Foreign Exchange Regulation Act, 1973 that no payment could be made to any person outside India except with the and in accordance with the exemption from the provisions of the Act being granted by the Reserve Bank of India until such permission was granted by Reserve Bank of India. Until then the liability was not enforceable and was, therefore contingent. The Tribunal also observed that CIT Appeals in Para 7 of his order has held that payment was due in the assessment year 1976-77 and as the appellant though following cash system of accounting did not make any provision, th appellant is not entitled to any reduction in respect of amount of Rs.89,722/-.

3. At the outset we may say there is no foundation for noticing about CIT (Appeals) finding `though following cash system of accounting'. On the close reading of the order of the CIT (Appeals) we do not find any such finding reached by the CIT (Appeals). We find from the order that the assessee has raised this

contention that the appellant was maintaining the accounts on cash system basis which was contested by the Income Tax Officer and the finding was that `it could not be said that the appellant maintained the accounts on cash system basis so far as this year'. It was the case of the assessee that only for the purpose of entry in question and for the year in question, he has followed the cash accounting system, otherwise he is following mercantile system. This plea did not find favour with the assessing officer nor with the CIT (Appeals). Therefore Tribunal in our opinion has erroneously assumed that CIT (Appeals) has found that the appellant though following the cash system of account, the deduction was not allowed because he did not make any provision.

Under Section 145 of the Income Tax Act, as it was in force during the relevant period, income under the head `profits and gains' of business or profession, where the assessee maintain books of account, has to be in accordance with method of accounts regularly employed by the assessee, which could be either cash mercantile or hybrid system. The assessee for any particular, source of income could adopt different system of accounting, but in no case, he could employ for part of the transactions or events relating to one source of income employed different system of accounting. The very foundation of assessee's plea is against this basic principle.

4. In concluding that because of the provision of Section 9 of the Foreign Exchange Regulation Act, the liability to pay did not become due and enforceable, in our opinion, the Tribunal has failed to perceive distinction between accrual of liability to pay on the one hand and procedure required for making such payment which has become due on accrual of such liability on the other hand. Provisions of the FERA has nothing to do with the accrual of liability which arises under terms of contract independent of the provisions of the FERA. The liability of the assessee to pay `know how fee' to the technical collaborator arise under the collaboration agreements. The consideration for which such agreement was entered is not governed by FERA. The liability to pay, and right of recipient of consideration to receive the same, and on failure of promisor to pay right to enforce does not depend on the permission or grant of exemption of Reserve Bank of India under Foreign Exchange Regulation Act. The fact that before actual payment is made permission of RBI is to be obtained, does not make the account and enforceability of liability subject to it. On the contrary it prima facie supports that there exist a valid liability to pay to grant such permission.

The object of FERA Act is not to control or regulate the obligation to pay any sum due to a non resident arising under a valid contract, but is to keep a check on unauthorised payment to and from non residents and regulate payments in foreign exchange. If payment under any provision of law is to be made only by way of a demand draft, it cannot be said that liability to pay accrued only when money is paid into the bank and demand draft is delivered by the bank. The liability to pay accrue independent of required procedure for payment, if any, prescribed under law is put in action. There is no doubt in the present case, nor any finding to the contrary, that so far as the liability of the assessee to pay the amount to its non resident technical collaborator under the contract became due in the previous year relevant to assessment year 1975-76 and not in the previous year relevant to assessment year in question. The only question that could have been germane for purpose of compounding profits and gains under the head business and profession of the year would be the method of accounting followed by the assessee regularly in respect of his business for which the technical know-how was obtained. There cannot be a piecemeal method of accounting in respect of the same business or the same source of income or expenditure. It cannot be said that for a source of income one system is followed, but for some of expenses required to be incurred for earning income from that source, a different method of accounting can be employed. Agreement to acquire technical know how for its business is not by itself a source of income for which different system of accounting could be maintained. It was very curious that the assessee had urged maintenance of cash system of accounting only for the transaction in question for the year in question and that too by pleading difficulty in making payment in the earlier year. The difficulty or time taken in following the procedure prescribed for making actual payment is hardly relevant for the purpose of maintenance of account on mercantile system. It often happens that there is gap between accrual of liability and its payment. The liability does not cease to be enforceable because of some procedure is required to be fulfilled on the part of the promisor under the agreement, for making such payment under any law. The fact that permission of Reserve Bank of India is required to be obtained is there in all cases payment is to be made or received from non residents. It is for the person liable to remit or receive payment to apply for the same. The fact that a person may apply for such permission in advance or one awaits until after it become due and payable, does not stop accrual of liability or make it contingent on happening of any

event. Else the result will be that notwithstanding liability to pay has arisen under the terms of agreement, the party under obligation to make payment, can postpone its accrual or enforceability at his free will, by choosing his own time to move the appropriate authority for such permission.

5. We may usefully refer to ratio in case of Mrs. Chandnee Widya Vati Madden v. Dr. C.Ol. Katial and Ors. AIR 1964 SC 978 which draws distinction between a contingent contract and a completed contract in order to appreciate distinction between a contingent liability and the liability which is crystalised. It was a case in which parties have entered into agreement to sell certain property. The law required the vendor to seek necessary permission to such transfer. The suit for specific performance of such agreement was sought to be the defended on the ground that the contract was contingent as its performance was dependant on permission to be granted by Collector. As to the obligation of the parties to the contract, the court said:

> "That the contract was not a contingent contract and that the parties had agreed to bind themselves by the terms of the document executed between them. The Court had got to enforce the terms of the contract and to enjoin upon the vendor to make th necessary application for permission."

6. In our opinion, the principle fully applies. Parties have entered into agreement on transfer of technical know-how with the permission of the Government of India. Under it liability of the assessee to pay fee for technical know-how accrued. The fact that actual payment could be made only with the permission of Reserve Bank of India, only put him under obligation to apply to the Reserve Bank of India for grant of necessary permission for releasing payment of amount to a non resident. But its enforceability is not contingent one.

In view of aforesaid discussion, we are of the opinion that the Tribunal has erred in allowing the sum in question as deduction for the assessment year in question by holding liability in the preceding year was contingent and became due and payable in the year in question only.

Accordingly, we answer question referred to us in

negative, that is to say, in favour of revenue and against assessee.

Assessee has not appeared in spite of service.

No order as to costs.

(Rajesh Balia, J)

(A.R. Dave, J)